S T A T E O F M I C H I G A N

STATE OFFICE OF ADMINISTRATIVE HEARINGS AND RULES

FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter of the application of **Wisconsin Electric Power Company** for authority to increase its rates for the sale of electricity in the State of Michigan.	))))))	Case No. U-15981

NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on May 7, 2010.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before May 21, 2010, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before June 2, 2010. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing of exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for

Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

STATE OFFICE OF ADMINISTRATIVE
HEARINGS AND RULES
For the Michigan Public Service Commission

Daniel E.
Nickerson, Jr.

Digitally signed by Daniel E. Nickerson, Jr.
DN: cn=Daniel E. Nickerson, Jr., c=US, email=denicke@michigan.gov
Date: 2010.05.07 17:02:12 -04'00'

Daniel E. Nickerson, Jr.
Administrative Law Judge

May 7, 2010
Lansing, Michigan
dmp

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PROPOSAL FOR DECISION

I.

HISTORY OF PROCEEDINGS

On July 2, 2009 Wisconsin Electric Power Company (We Energies) filed an application requesting authority to increase its rates by about $42 million annually. Along with its application, We Energies also filed supporting testimony, exhibits, workpapers and responses. The application laid out a three step process for increased rates:

(i) about $21,218,960 annually to be self-implemented 180 days from the date of the filing of the application or the commencement of commercial operations of the Elm Road Generating Station Unit 1;

(ii) about $27,659,317 annually, including the self-implemented revenues, upon authorization by the Michigan Public Service Commission;

(iii) about $4,444,683 annually upon the commencement of commercial operation of the Elm Road Generating Station Unit 2 expected to occur in August 2010.

On July 29, 2009 the Michigan Public Service Commission (Commission) issued its Notice of Hearing. On August 18, 2009, a prehearing was held before Administrative Law Judge Daniel E. Nickerson, Jr. (ALJ). At the prehearing, intervention status was granted to Tilden Mining Company L.C. and Empire Iron Mining Partnership (the Mines), and Louisiana-Pacific Corporation (Louisiana-Pacific). The Commission Staff (Staff) filed its appearance. A schedule was set. The schedule provided, among other dates, for a hearing date and the filings of testimony concerning We Energies' request to self-implement.

On September 1, 2009 We Energies filed an Application for Leave to Appeal and supporting brief with the Commission contesting the setting of a hearing and filing of testimony on its request for self-implementation. The Mines and Louisiana-Pacific filed responses in opposition to the Application for Leave to Appeal.

On September 17, 2009 Attorney General Michael Cox (AG) submitted a late-filed petition to intervene. The parties stipulated to grant the intervention of the AG.

On October 13, 2009 the Commission issued an Order which revised the schedule set by the ALJ. The Commission eliminated the filing of testimony, rebuttal testimony, motions to strike, briefs, and reply briefs on the self-implementation. The Commission also required We Energies to file its proposed tariffs for self-implementation. The Commission further scheduled a hearing for October 29, 2009 at which We Energies was directed to present one witness to support the reasonableness of its proposed tariffs and evidence regarding the effect of the statutory rate design option. All other parties were permitted to present one witness each.

On October 28, 2009 the Mines and Louisiana-Pacific filed responses to We

Energies' proposed self-implementation rates. The hearing was held on October 29 and October 30, 2009. We Energies and the Mines presented one witness each. The other parties did not present a witness.

On December 7, 2009 We Energies filed a Notice of Filing of Revised Self-Implementation Rates that proposed to reduce the level of self-implementation to about $12,000,000 annually effective on January 1, 2010 or the commencement of commercial operation of the Elm Road Generating Station (ERGS) unit 1 whichever was later. On December 16, 2009 the Commission issued an Order approving We Energies' proposed self-implementation limited to $12,000,000 and required We Energies to credit its customers with $2,159,000 from the proceeds associated with the sale of the Point Beach Nuclear Power Plant plus interest.

On January 5, 2010 Staff, the Mines, Louisiana-Pacific and the AG filed direct testimony pursuant to stipulations for extension. On January 20, 2010 the Mines filed revised testimony incorporating a revised projection of the Mines' 2010 electric consumption level.

On January 29, 2010 We Energies, Staff, and the Mines filed Motions to Strike. We Energies also filed a Motion to Compel Discovery. On February 1, 2010 We Energies filed a written response to the Mines and Staff's motions to Strike.

On February 2, 2010 We Energies filed an Affidavit which attested to the commencement of commercial operations of the ERGS Unit 1.

On February 1 through February 4, 2010 hearings were held. A protective order approved by the parties was entered on February 5, 2010. By stipulation of the parties, dated February 9, 2010, additional exhibits A-39 to A-41 were admitted and the record was closed.

On March 5, 2010, initial briefs were filed by We Energies, Staff, the Mines, Louisiana-Pacific, and the AG. On March 19, 2010, reply briefs were filed by We Energies, Staff, the Mines, Louisiana Pacific, and the AG. The record consists of a transcript containing 1455 pages and 183 exhibits admitted into evidence.

II.

INTRODUCTION AND OVERVIEW

This is the first time that We Energies is seeking to recovery rates for ERGS #1 and ERGS #2 through the Commission. We Energies does not own ERGS #1 and ERGS #2. Rather, ERGS #1 and ERGS #2 are owned and operated by W.E. Power, an unregulated company. W.E. Power was formed in 2004 for the purpose of constructing, owning, and leasing the generation capacity of ERGS #1 and ERGS #2 to We Energies. The revenue requirements resulting from the costs of construction, commencement of operation, and leasing of ERGS #1 and ERGS #2 are major issues raised in this case.

III.

TEST YEAR

We Energies proposes a fully-projected 2010 calendar test year which runs from January 1, 2010 to December 31, 2010. We Energies relies on the provisions of MCL 460.6a(1) and previous Commission orders which have approved the use of fully-projected test years. We Energies presented the testimony of Mary L. Wolter to describe the principles, inputs, and methodologies used to develop the fully-projected test year.

While the parties dispute various components of We Energies' fully-projected test year, there is not any real issue raised regarding the use of a fully-projected test year in this case. The statutory authority provides that "A utility may use projected costs and revenues for a future consecutive 12-month period in developing its requested rates and charges." MCL 460.6a(1). The Commission has approved the use of fully-projected test years. In doing so, the Commission focused the discussion on a going-forward basis. The Commission examines strengths and weaknesses of the evidentiary presentations of the parties regarding specific expense and revenue projections. Since there is not any real dispute concerning the use of a fully-projected test year, the ALJ will focus further discussion on the evidentiary presentations as related to specific expense and specific revenue projections.

IV.

RATE BASE

A utility's rate base consists of the capital invested in used and useful plant, less accumulated depreciation, plus the utility's capital requirements. *MPSC Case No. U-15768,* dated January 11, 2010, p. 12. In this case, We Energies' presented testimony and exhibits supporting its 2010 test year rate base. In addition to the above rate base components, We Energies includes Construction Work in Progress (CWIP).

We Energies presents as its projected total company rate base $4,986,390,322 as well as its Michigan jurisdictional total basis of $290,395,881. Exh. A-2, Sch. B-1.

A. <u>Net Plant</u>

We Energies proposed a net plant of $4,667,323,780 on a total company basis. Exh. A-2, Sch. B-1, line 11. The amount of the proposed net plant is challenged by the Intervenors and to a lesser extent by Staff. The basis of the challenge relates to the application of used and useful as it relates to the inclusion of ERGS #1 and ERGS #2 in net plant[1].

ERGS #1 and ERGS #2 are base load plants approved by the Public Service Commission of Wisconsin (PSCW). ERGS #1 began commercial operation on February 2, 2010. We Energies expects that ERGS #2 will commence commercial operations in August 2010.

ERGS #1 is a 615 Megawatt, super-critical, pulverized-coal plant. ERGS #2 is a 615 Megawatt, super-critical, pulverize-coal plant. Both, ERGS #1 and ERGS #2 were constructed by and are owned by W.E. Power. W.E. Power is an unregulated company which was formed in 2001 for the purposes of constructing, owning, and leasing generating capacity of ERGS #1 and ERGS #2.

1. <u>Used and Useful</u>

A major issue raised by the Mines, Louisiana-Pacific, and the AG is whether ERGS #1 and ERGS #2 qualify as used and useful. The Mines, Louisiana-Pacific and the AG point to We Energies' high levels of generating capacity over reserve margins, in part, to question whether the plants are used and useful. We Energies admits that it

[1] The expenses and leases related to ERGS #1 and ERGS #2 are also contested and discussed later in this Proposal for Decision.

currently has capacity in excess of its reserve margin. However, We Energies argues that used and useful has aspects not considered by the Mines, Louisiana-Pacific, and the AG. We Energies also notes that a reduction in its planned reserve margin from 18% to 14.5% has contributed to its generating capacity exceeding reserve margins.

The Mines brief contains a number of cases which discuss the doctrine of used and useful and its application. In a general sense, the cases cited by the Mines recognize that excess capacity may result in a finding that the proposed plant is not used and useful. Most significant, to the ALJ, is that the Mines discussion includes prior Commission decisions on the subject. While the decisions from courts, and other commissions no doubt guide the Commission, the ALJ finds that the decisions of the Commission as it relates to the doctrine and its application are controlling.

In this regard, the Mines summarize Commission decisions as applying the used and useful doctrine into two inquires. The first is whether the plant is used by the ratepayers. The second is whether the plant is useful to the ratepayers. Specifically citing to the Commission, the Mines rely on the following:

> New generating plants must be used by the utility in question to provide service and they must also be useful in the provision of service. Under this standard, it is not enough for a utility to build a generating plant and then operate the plant successfully. The plant must also provide benefits to the customers served by the utility. *MPSC Case No. U-7660,* dated April 1, 1986, pp. 91-92.

Expounding further the Commission states:

> There are two ways in which a power plant may be useful to the ratepayers of a public utility. The power plant may be useful and indeed necessary to provide adequate and reliable electric service for a utility's customers.

* * * * * * * *

> The second way in which a power plant may be useful to ratepayers of a regulated utility concerns the cost benefits associated with such a power plant. If the new generating unit, on a cumulative basis, can produce savings which exceed both capital and operating cost, that plant is useful to customers on an economic basis. Id, p. 96*.*

In another case, the Commission further stated:

> Unfortunately, there is no statutory or common law standard in Michigan for when a plant is considered "used and useful." The Commission believes that catch-words and catchy phrases can be misleading if common sense is not used when applying them to the facts of a case like this. The rationale behind the "used and useful" standard is to avoid allowing a utility to earn a return on property which is not being utilized toward the ultimate goal of providing service to utility customers. *MPSC Case No. U-6006,* dated March 14, 1980, p. 14.

The ALJ notes that in both of the above cited cases, the Commission made determinations finding the plants used and useful. However, there are a number of cases cited by the Mines where contrary determinations have been found and the courts and state and federal commissions have made determinations concerning plant which is not used and useful.

Louisiana-Pacific also relied on a Commission order in arguing that the ERGS units are not used and useful. In Michigan, this Commission has long held that the investment on which a utility is entitled to earn a fair return is limited to that which is used and useful. *MPSC Case No. U-7830 Step 3B (Part 1 of 2),* dated May 7, 1991, p. 36.

Staff counters the Mines and Louisiana-Pacific's application of used and useful by citing later Commission precedents after the Commission order in MPSC Case No. U-7660 which show that the Commission has more choice and more flexibility when it comes to rate base determinations. Staff argues that the Commission in MPSC Case

No. U-7660 did not exclude plant built in anticipation of future needs as useful to provide reliable and adequate service in the future.

Staff cites to several Commission decisions in cases where excess capacity was an issue. In those cases, the Commission addressed the application of used and useful. The Commission when rejecting an argument that the plant was not used and useful because there was not an immediate need stated:

> This contention ignores the fact that most plant investment is related to peak sales levels rather than annual sales levels. *MPSC Case No. U-7298,* dated November 9, 1983, p. 7.

The Commission, in approving costs for Consumers Energy Company's Marysville synthetic natural gas plant even though the plant was out-of-service and had not been used for years, stated:

> It is appropriate at this time to bring into focus the concept of 'used and useful' property for rate-making purposes. The commission is in agreement that 'used and useful' is a flexible ratemaking tool whose definition to some extent is shaped by the individual circumstances of each case. Whether property is used and useful in providing service to the customers of a utility is a question which of necessity must be resolved to the basis of a case-by-case analysis. The status of plant cannot be determined through the application of any set formula but should be ascertained in light of all the circumstances. *MPSC Case No. U-5732,* dated April 12, 1983.

On appeal, the Court of Appeals upheld the Commission. The Court recognizing that that the plant was not currently producing stated:

> When the PSC rendered its decision, the Marysville plant was not producing synthetic natural gas and apparently would not be needed for the next several years because natural gas was available from other sources. However, evidence indicated that the "supply bubble" would end, causing a future need for the Marysville plant to produce synthetic natural gas. A utility is entitled to a return on the value of the property which it employs for the convenience of the public. *General Motors Corp v Public Service Comm ("Marysville I"),* 175 Mich App 576, 582; 438 NW2d 613 (1988).

About six years later, the Marysville plant was still not operational. ABATE challenged the amortization expenses for the plant. The Commission, in rejecting ABATE's arguments held that:

> Accordingly, the fact that Consumers has not in the past ten years and may not in the foreseeable future need to rely on its Marysville SNG plant for its gas supply requirements does not necessarily mean that ratepayers are not realizing a benefit from continuing the plant as an insurance police against another supply shortage. *MPSC Case No. U-8678,* amended order.

We Energies argues that a facility many be used and useful in several respects. Ms. Wolter testified as follows:

> So to the extent that a plant doesn't show that there may—they may project that there's no usage in a given year, but that doesn't mean that they couldn't be called upon by MISO, for instance, for reliability reasons, or called upon by the Company if the economics change during a given year. 5 Tr 584.

We Energies argues that even though a Company's generating capacity may exceed its current reserve margin does not show or support a finding that plant is not used and useful in order to remove it from rate base. We Energies relies on a finding of the PSCW recognizing that many of the Company's generating units were construed years ago. Exhibit A-23, p. 21. We Energies argues that replacing older units with new more efficient, more environmentally friendly units, shows the newer units are used and useful. We Energies opposes any proposed adjustments to its rate base as unsupported by the evidence and without basis or merit.

Based on the above Commission precedents, the ALJ concurs with We Energies and Staff's assessment that "used and useful" is a flexible ratemaking tool. The ALJ further finds that the Commission has wide discretion whether to use "used and useful" or some other ratemaking tool. The ALJ further finds that future use, as an insurance policy, and convenience of the public are recognized by the Commission as a basis for finding plant not currently under operation used and useful.

2. Excess Generating Capacity

In this case, the ALJ finds several aspects concerning excess generating capacity which must be considered. First, the observation made by We Energies that many Midwestern electric companies have excess capacity and next, the nature of the size of We Energies' excess capacity. We Energies states that like many Midwestern electric utilities, it has capacity in excess of its reserves. We Energies states that several factors contribute to this excess over reserves including a reduction of its planned reserve margin from 18% to 14.5% and new base load generating units (EGRS) and the significant economic downturn.

The ALJ finds that there is insufficient evidence to draw much of a conclusion from We Energies' observation concerning many Midwestern electric companies having excess capacity. However, the observation is troubling in several respects. One, there is obviously a cost associated with excess capacity. Two, it appears as though this observation is offered to show that excess capacity is a present day norm. Again, the ALJ finds that there is insufficient evidence concerning such broad brush stroke observation to draw much of a conclusion. However, it is a part of the record presented in this case. It is also noteworthy that the PSCW has opened a generic case proceeding for the purpose of investing the surplus generating capacity of Wisconsin utilities for the purpose of determining the best solution to maximize the surplus capacity to the benefit of ratepayers. Exhibit MIN-57, p. 17.

The ALJ finds this observation of excess or surplus generating capacity in the Midwest a concern since We Energies cites the possible sale to MISO of excess generating capacity for reliability dispatch as a factor for determining whether the excess generating capacity is used and useful. 5 Tr 584. The ALJ reasons that excess generating supply in general in the Midwest makes it more difficult to dispatch the excess generating capacity of a given particular generating unit, in this case, ERGS.

The AJ finds that Exhibits MIN-62 and LP-2 are revealing. These exhibits show We Energies Capacity and Reserve Requirements for Peak Month 2010-2014 and 2010-2015, respectively. The Mines witness, Michael P. Gorman sponsored Exhibit MIN-62. He testified that the exhibit was prepared using We Energies' native load requirements excluding unexplained and currently non-firm commitments. We Energies has over 750 MW of excess generating capacity each year over the next five years not including ERGS #2. Including ERGS #2, We Energies would have over 1,030 MW of excess generating capacity.

Mr. Gorman testified that at no time during the entire five-year forecast is ERGS #2 needed to meet peak demand. Also, based on current projections We Energies has excess capacity through 2018. Mr. Gorman's testimony is not disputed.

Louisiana-Pacific witness Charles W. King sponsored Exhibit LP-2 which is similar in nature to Mr. Gorman's Exhibit MIN-62. Mr. King testified that his projections were understated because it assumes that there is over 200 MW of capacity which may be sold to undesignated third parties. Mr. King's testimony is not disputed.

ERGS #1 and ERGS #2 are more efficient than generating units currently in We Energies' portfolio. Both units are coal fired units which are the lowest cost fuel on a

BTU basis at the present time. However, Mr. Gorman testified that the lower fuel costs falls short of added fixed cost increase of the new units. Mr. Gorman testified that the fuel savings is about $5-$36/MWh, while the increased fixed costs range between $48-$55/MWh. 6 Tr 876 and Exhibit MIN-63.

The ALJ recommends that based on the level of excess generating capacity that the Commission, as proposed by the Mines and noted by Staff but not recommended by Staff, phase into rate base the costs associated with the ERGS #1 unit as the Commission did in *MPSC Case No. U-7660,* dated April 1, 1986, pp. 91-96. While the phase-in should be based on the facts of this case, the ALJ finds it instructive to consider the Commission's determinations in *MPSC Case No. U-7660* concerning the phasing-in of Fermi 2. The Commission considered the reserve requirement and noted that Fermi 2 capacity would be necessary in about three years. Id. p. 94 The significant difference, in this case and the Fermi 2 case is that none of the projections show a need for ERGS #1 and ERGS #2 generating capacity in the near future. Whereas, the Commission found a reasonable range for determining the need for the capacity of Fermi 2 from the record presented.

The ALJ recognizes as noted by numerous expert witnesses that a major driver of the actual need of ERGS #1 and ERGS #2 generating capacity is keyed to economic recovery. However, evidence is lacking to substantiate with any certainty the rate of economic recovery. Therefore, the ALJ recommends that the phase-in be determined over subsequent rate cases in which the appropriate measures of need may be submitted by the parties and ascertained by the Commission. In the meantime, the ALJ recommends similar to the Commission's position concerning Fermi 2, that 25% of the costs of ERGS #1 be included in rate base due to the lower cost of fuel and the availability of ERGS #1 to provide reserve and reduced capital costs in not planning future generating capacity. Based on the above, the ALJ further recommends as Staff proposed, that ERGS #2 not be include in rate base.

B. Working Capital

We Energies proposes working capital on a total-company basis in the amount of $319,066,542. Exhibit A-2, Sec B-1, line 12. We Energies conditionally accepts Staff's calculated working capital on a total-company basis in the amount of $332,665,524. Exhibit S-2, Sch. B-1, line 12. We Energies only conditionally accepts Staff's proposal because of Staff's proposed reduction in Total Regulatory Assets by $17,380,517. We Energies witness Ms. Wolter testified regarding what they claim as the inappropriate nature of the Total Regulatory Asset. She states:

> The lease prepayments associated with both the ERGS and PWGS projects represent cash lease payments made during construction of the units. Because they represent actual cash payment made by WEPCO, they should be included in the calculation of the working capital requirement of the utility. The fact that the unit will not go into service until a month after the rates are in effect does not, and should not, exclude them from the working capital calculation. 4 Tr 506.

The ALJ does not agree with We Energies. As discussed below, even though the lease payments are cash payments, the plant going into service triggers the plant as a component of net service as such it is the plant in service which triggers the inclusion of the payment of the lease payments in working capital.

The ALJ further recommends Staff's proposed allowance for working capital in the amount of $63,234,999. This proposed amount properly reflects two adjustments from We Energies' proposed amount. The first is the removal of ERGS # 2. The second is the removal of the recommended disallowance for incentive compensation from O&M.

V.

RATE OF RETURN

The ALJ is guided by prior Commission determinations for establishing rate of return for public utilities. The Commission has cited and relied on the landmark United States Supreme Court decisions in *Bluefield Water Works Co v Public Service Comm of West Virginia,* 262 US 679; 43 S Ct 675; 67 L Ed 1176 (1923) and *Federal Power Comm v Hope Natural Gas Co,* 320 US 591; 64 S Ct 281: 88 L Ed 333 (1994). The Commission has stated that these decisions make it clear that consideration should be given to both investors and customers when setting a fair rate of return. *MPSC Case No. U-15768,* supra, p. 16. The Commission has stated that the rate of return should not be so high as to burden ratepayers, yet high enough to ensure investor confidence in the financial soundness of the company. *Id, p 17.* In reaching a conclusion as to what is fair or reasonable, there is not a precise mathematical formula but rather it requires a comprehensive evaluation of all factors involved. *Meridian Twp v City of East Lansing,* 342 Mich 734, 749; 712 NW 2d 234 (1955).

A. Capital Structure

We Energies proposes a capital structure of 41.41% long-term debt, .59% preferred equity, and 58.00% equity. Exhibit A-4, Schedule D1.

B. Capital Structure Balances

1. Short-Term Debt

We Energies accepted Staff's proposed increase of short-term debt to reflect a more recent change in anticipated financing being issued as short-tem debt, rather than long-term debt. The uncontested amount of short-term debt is $440,401,957. The ALJ recommends this amount to the Commission.

2. Long-Term Debt

We Energies proposed long-term debt in the amount of $1,985,000,000 after accepting Staff's proposed adjustment. Staff's proposed adjustment concerns changing some debt from long-term debt to short-term debt. We Energies rejects Louisiana-Pacific's proposed adjustment to increase long-term debt by $813,800,000 through the treatment of various long-term leases as long-term debt.

Ms. Wolter and Mr. King actually agree on one point as it relates to the treatment of the long-term leases. Both recognize that credit rating agencies include long-term leases as debt for credit rating purposes. However, Ms. Wolter and Mr. King disagree as to how the long-term leases should be treated for ratemaking purposes. The ALJ finds that while Mr. King's proposal is reasonable in terms of accurately reflecting the capital structure of We Energies, it is not consistent with traditional ratemaking practices. The ALJ recommends the adoption of We Energies' proposed long-term debt in the amount of $1,985,000,000.

3. Preferred Stock

We Energies proposed preferred stock in the amount of $30,449,800. This amount is not contested.

4. Common Equity

We Energies initially calculated common equity in the amount of $3,009,865,693. Exhibit A-4, Schedule D-1. Staff proposed to reduce the amount of common equity by $280,377,000 which was the 13-month average investment in American Transmission Company, LLC. Mr. Gorman and Mr. King also proposed reductions in the amount of common equity to remove the investment Staff cited above as well as Bostco. We Energies agreed to these proposed adjustments. The resulting amount of common equity proposed and uncontested is $2,766,300,000. Exhibit LP-3.

5. Deferred Income Taxes

We Energies proposed a Deferred Income Tax (DIT) balance in the amount of $496,013,460 million. Exhibit A-4, Schedule D-6. This amount is contested by Staff and the Mines.

Staff's witness Kavita B. Bankapur initially recommended a DIT in the amount of $496 million. Staff states that subsequent to rebuttal testimony and cross-examination, it now supports a DIT in the amount of $605 million. Staff states this new DIT amount is the result of making corresponding adjustments to the long-term debt and equity balances.

We Energies objects to the requested adjustment by Staff. We Energies notes that Staff for the first time seeks to adjust the DIT in its initial brief despite having filed rebuttal testimony and presenting a witness recalled to testify about the DIT.

The basis for We Energies' proposed DIT is found in the removal of the Wisconsin-jurisdictional regulatory assets and liabilities from working capital in the amount of $109,000,000. Exhibit A-4, Schedule D-6. Apparently, Staff added back the

$109 million to arrive at its proposed DIT in the amount of $605 million. The problem however and the ALJ concurs with We Energies on this point, Staff does not specifically reference how or more importantly why it was appropriate to include the Wisconsin-jurisdictional amount in DIT. Without more, the ALJ must recommend rejection of Staff's proposed DIT.

The Mines through discovery requests obtained a table which reconciles the DIT liability as presented in this case to the filing in the Wisconsin rate case. Exhibit MIN-58. The Mines argue that We Energies is substantially overestimating its cost of capital by not including the total regulated company capital structure. The Mines proposed a DIT in the amount of $791.345 million. Exhibit MIN-58, p. 4.

Concerning the Mines proposed adjustment to DIT, the ALJ concurs with We Energies. In order to accept the Mines proposed DIT, the accounts associated with the DIT liabilities would have to be included in the Michigan jurisdictional rates. Since, these amounts have been excluded by We Energies; the associated DIT liabilities should likewise be excluded. The ALJ recommends a DIT balance in the amount of $496,013,460.

6. <u>Job Development Investment Tax Credit</u>

We Energies proposed a Job Development Investment Tax Credit (JDITC) amount of $32,060,245. Exhibit A-4, Schedule D1. There was no dispute raised concerning the JDITC amount.

C. Capital Structure Rates

1. Short-Term Rates

We Energies, in its initial application, projected a cost of short-term debt of 3.32%. Exh. A-4, Sch. D-1. In rebuttal, We Energies proposed the cost of short-term debt as 1.56%. Staff proposed a short-term debt cost of 0.99%. The Mines proposed a short-term debt cost of 1.32%.

The ALJ recommends a short-term cost of debt as proposed by We Energies, in its rebuttal, of 1.56%. The ALJ is persuaded by Ms. Wolter's testimony concerning the timing of the effective date of the short-term interest rates and the reasonable projections for the later part of 2010.

2. Long-Term Rates

We Energies initially proposed the cost of long-term debt at 5.70%. Exhibit A-4, Schedule D-1. This cost was adjusted based on the issuance of long-term debt on December 8, 2009 at a cost lower than projected. Also, an adjustment was calculated to reflect a recent change of financing being issued as short-term debt rather than long-term debt. The ALJ recommends the cost of long-term debt at 5.64%. Exhibit S-4, Schedule D-2.

3. Preferred Stock

All parties used a cost rate of 4.01% for preferred stock. Exhibit A-4, Sch. D-1. The ALJ recommends the cost of preferred stock at 4.01%.

4. Cost of Common Equity

There are five parties to this case. There are four different proposed costs of rates of return on common equity[2]. However, all parties to the case, recognize the general legal parameters for the establishment of a reasonable rate of return. Generally, the criteria requires consideration of the interests of both investors and customers. The United States Supreme Court Opinion cited by all the parties to this case states:

> …the return to the equity owner should be commensurate with the returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital. Federal Power Commission v. Hope Natural Gas Co., 320 US 591, 603, 64 S Ct 281, 88 Led 333 (1944).

Also, cited by the parties is the Commission's discussion on the general legal parameters for the establishment of a reasonable rate of return. The Commission states:

> The criteria for establishing a fair rate of return for public utilities is rooted in the language of the landmark United State Supreme Court cases Bluefield Water Works Co v Public Service Comm of West Virginia, 262 US 679; 43 S Ct 675; 67 L Ed 1176 (1923) and Federal Power Comm v Hope Natural Gas Co, 320 US 591; 64 S Ct 281; 88 L Ed 333(1944). The Supreme Court has made clear that, in establishing a fair rate of return, consideration should be given to both investors and customers. The rate of return should not be so high as to place an unnecessary burden on ratepayers, yet should be high enough to ensure investor confidence in the financial soundness of the enterprise. Nevertheless, the determination of what is fair or reasonable, "is not subject to mathematical computation with scientific exactitude but depends upon a comprehensive examination of all factors involved, having in mind the objective sought to be attained in its use." Meridian Twp v City of East Lansing, 343 Mich 734, 749; 71 NW 2d 234 (1955).

[2] The AG did not submit a separate proposal for the rate on common equity. Rather, the AG concurred with the proposal submitted by the Mines.

After the parties have applied various acceptable models for computing a reasonable rate of return, each of the parties applied some judgment to the computations to arrive at their respective proposed rates of return. The following table illustrates the various proposed rates of return on common equity.

Party	Proposed Rate of Return
We Energies	10.75%
Staff	10.25%
The Mines	10.05%
Louisiana-Pacific	10.10%

As stated above, all of the parties used various models to calculate ranges of rates for common equity. Also, as noted above, a reasonable rate of return is not subject to precise mathematical computation. Once, the models were used, all of the parties applied a level of judgment to establish their respective proposed rate of return.

The ALJ is persuaded that Staff through the use of various models, reliable sources, and expert judgment presents a well reasoned proposed rate of return of 10.25%. The ALJ finds that none of the other parties took into consideration as many factors and reliable sources as did Staff. Moreover, the ALJ found Staff's consideration of appropriate representative proxy group of companies to be persuasive. Staff states that its proxy group closely resembled We Energies in several very important characteristics including risk.

The ALJ considered We Energies criticism of Staff's assessment as unreasonably low and also that Staff performed ROE studies do not support Staff's proposed cost of equity. We Energies references recent Commission awarded cost of equity to show that Staff's proposal is too low. Staff believes the each utility is separate and distinct. Staff points out that reliance on a Commission approved cost of common equity for one utility does not serve as a measure of reasonableness in this case. The ALJ concurs. The ALJ further finds that Staff considered the facts and evidence specific to We Energies, again, and, in particular, the appropriateness of its representative proxy group in presenting its proposed cost of equity. The ALJ recommends the Commission adopt Staff's proposed cost of equity at 10.25%.

D. Overall Rate of Return

The ALJ proposes the overall rate of return as computed in the attached table.

Description	Amount	Ratio	Cost Rate	Weighted Cost
Short-term Debt	$ 440,401,957	7.66	1.56%	.12%
Long-term Debt	$1,985,000,000	34.52	5.64%	1.95%
Common Equity	$2,766,300,000	48.11	10.25%	4.93%
Preferred Stock	$ 30,449,800	.53	4.01%	.02%
DIT	$ 496,013,460	8.6%		
JDITC				
Short-term	$ 2,732,071	.05%	1.56%	.00%
Long-term	$ 12,314,117	.21%	5.64%	.01%
Common	$ 16,825,158	.29%	10.05%	.03%
Preferred	$ 88,898		4.01%	.00%
	============	======	=======	=======
Total	$5,750,225,462			7.06%

VI.

ADJUSTED NET OPERATING INCOME

The adjusted net operating (NOI) income is the difference between operating revenues and operating expenses. NOI includes all projections, disallowances, and normalizing adjustments to operating revenues and operating expenses. We Energies, in its application, calculated an adjusted Michigan retail NOI at a loss of $2,947,842.

Exhibit A-3, Schedule C1. We Energies has modified certain positions and has calculated a revised adjusted Michigan NOI of $2,178,316 for 2010 the projected test year. A major issue concerning the NOI involves the sales projection for the Mines and others as discussed below.

A. <u>Sales Forecast</u>

We Energies proposes a revised projected 2010 sale forecast on a total-company weather-normalized basis of 29,816,613 MWh, with Michigan 2010 sales (without Special Contracts of 2,100,407 MWh). We Energies' forecast included a projected Mine load of 1,436,090 MWh and projected other sales of 664,317 MWh. Exhibit A-6, Schedule F2.

1. <u>Mines Sales Forecast</u>

The Mines energy consumption represents about 68%-75% of the total Michigan retail sales load. Therefore, the Mines sales forecast significantly affects other aspects of We Energies' application. There is a significant difference between We Energies' forecast for the Mines of 1,436,090 MWh and the Mines' own revised forecast of 2,203,000 MWh.[3] Staff initially projected the Mines' consumption at 2,074,109 MWh based upon We Energies' last rate case. *MPSC Case No. U-15500.* 6 Tr 1204. Staff now agrees with the Mines' revised consumption level of 2,203,000 MWh noting recently increased production. 6 Tr 1204.

We Energies' witness James M. Kochevar testified that he revised his projection in July 2009. Mr. Kochevar based his projections on his knowledge of the Mines' actual operating plans for the year. He states:

[3] The Mines projected consumption in the amount of 2,415,000 MWh in November, 2009 and subsequently revised this projection to the consumption level of 2,203,000 MWh.

> …Approximately 80% of the Mines' electrical consumption is in grinding ore to recover iron. The remaining 20% is utilized for kiln operation and other general site operations. Composition of the ore in its naturally occurring state varies from mine site to mine site. Advanced testing of locations to be mined in 2010 indicates a significant grinding task (lower iron recovery). 5 Tr 728.

The ALJ is convinced that the Mines presented the projection of their own sales which should be more accurate. First, it is more timely than the projection of We Energies. Second, and more importantly, it specifically takes into account the locations to be mined and the nature of the ore from testing samples. In 2009, the Mines' electric consumption totaled 1,518,370 MWh. Exhibit MIN-54, p. 4. The Mines note that the later part of 2009 there was increased electric consumption. This is supported by the electric consumption shown for October, November, and December 2009. Exhibit MIN-54, p. 4. Exhibit MIN-54 shows both the actual mine load and non-mine load for 2009.

Mr. Rogers testified that the Mines five-year historical average consumption level is 2,224,536 MWh. This places the Mines' projection actually lower than historical averages but closer to the five-year historical average than We Energies' projection. The ALJ recommends that the Commission adopt the Mines' projection of consumption in the amount of 2,203,000 MWh.

2. Forecast of Non-Mine Load

We Energies projects a non-mine load of 664,337 MWh. Exhibit A-6, Schedule F2, p. 1. The Mines project a non-mine load of 820,333 MWh. We Energies' projection is based on its methodology. The Mines took the 2009 actual non-mine sales and proposed to use that figure as the projection for non-mine sales for 2010. Exhibit MIN-54. In support of this proposal, Mr. Gorman states:

> While Michigan's economy remains one of the worst, if not the worst, economy in the nation, I believe Michigan's economic decline has started to stabilize. Michigan's unemployment rate has hovered around 15% for several months now. Moreover, the nation's economy has also stabilized which is indicative of the general business climate. I certainly do onto expect to see another rapid decline in the economy in 2010 as we saw at the end of 2008. 6 Tr 863-864.

Staff supports the Mines' non-mine projection. Staff in doing so states that the We Energies figures reflect the recession that existed at the time of its filing its application however, the Mines' updated sales figures reveals that the non-mine customers may be less economically distressed then originally anticipated.

The ALJ believes that it is more reasonable to use the 2009 actual non-mine sales consumption as the 2010 sales consumption projection than We Energies' projected non-mine sales for 2010. The ALJ is persuaded by Mr. Gorman's testimony and by Staff's acceptance that the economic downturn has stabilized to the extent that there should not be further decline in non-mine consumption in 2010.

3. <u>Impact of Additional Sales on Revenue Deficiency and Rates</u>

We Energies argues that projections of additional sales forecast must be adjusted by its cost of service study (COSS). We Energies states that it has provided its COSS to the parties under the provisions of Commission order in MPSC Case No. U-15895. We Energies argues that cost of service principals are encompassed by Michigan law. MCL 460.11(6). We Energies asserts that any adjustments in sales must be run through the COSS so as to be properly allocated. Staff, similar to We Energies, incorporated the projection of additional sales into the COSS.

The Mines calculated the additional revenues from its proposed sales adjustments at current PSCR rates of $41.71/MWh. MIN 52-R. The Mines did not run the projection of additional sales through the COSS.

The ALJ finds that We Energies is correct. Under the provisions of MCL 460.11(6) and MPSC Case No. U-15895 the sales adjustments should be run through We Energies' COSS for proper allocation. Whatever sales projections are determined, the determined sales levels must be appropriately inputted into the COSS.

4. Miscellaneous Revenue

We Energies accepts Staff's proposed adjustments to the category of miscellaneous revenues. These proposed adjustments include the Michigamme Reservoir Billing Revenues referenced as well by the Mines. The net amount of the miscellaneous adjustments is $26,730,695.

B. Operation and Maintenance Expenses

The major issue to be addressed under expenses concerns the leases We Energies has contracted with W.E. Power for the purchase of the generating capacity of ERGS #1 and ERGS #2. The commercial operations of the ERGS units trigger the commencement of obligations to make lease payments for the generating capacity. This increases We Energies' Operating and Maintenance (O&M) costs. The amount of the ERGS #1 lease, as set forth by We Energies, is $10,691,180. Exhibit A-3, Schedule C15, line 25. The amount of the ERGS #2 lease, as set forth by We Energies, is $4,062,651. Exhibit A-3, C15, line 33. We Energies argue that while the costs in rates of these units are significant, recovery of reasonable costs is well-established under ratemaking principles.

We Energies argues that since the PSCW, in approving its Power of the Future Plan (PTF), approved the lease provisions that the arrangement by We Energies for constructing, operating, and leasing the ERGS units are reasonable and prudent. We Energies relies on numerous findings by the PSCW which We Energies urges the Commission to accept and approve. Among the most significant findings made by the PSCW upon which We Energies relies and urges the Commission to approve are noted below:

- The need for construction of the ERGS units
- The timing of the construction of the ERGS unit
- The ownership, construction, finance, operation and maintenance via an affiliate
- The impact of the affiliate lease for generating capacity

This list is not exhaustive. However, it does in summary fashion reasonably identify the major factors which We Energies wants this Commission to accept and approve.

The Mines argue that the leases should only be discussed if the Commission permits the inclusion of ERGS costs in the cost of service. The Mines further oppose the terms of the PTF lease expenses as not reasonable capital costs. The Mines urge the Commission to adjust the terms of the leases to reflect fair compensation for the investments of the PWGS and ERGS units. The Mines argue that the leases involve an affiliate transaction and as such warrants an independent review by this Commission.

Louisiana-Pacific argues that the ERGS units are not used and useful for supplying electricity and therefore the leases should not be included in rates. Louisiana-Pacific also notes the affiliate transaction nature of the leases. Louisiana-

Pacific proposed an adjustment to the rate of return and the amortization period under which the lease payments are calculated.

The AG argues that the leases are several times higher than the market prices for leasing generating capacity. The AG questions whether the affiliate transaction resulted in more favorable terms to the affiliate than what would have been obtainable in the market. The AG also questions whether the provisions of the leases are contrary to the Uniform System of Accounts (USOA).

The ALJ finds that the lease expenses should be deferred until the Commission has approved recovery through a determination that the ERGS units are used and useful. The ALJ further recommends that should the Commission find that the ERGS generating facilities are used and useful then the amount of the leases should be adjusted to market based prices.

The ALJ finds that the findings of the PSCW are not binding on this Commission. There has not been any legal authority cited to sustain such a finding. More significantly, the ALJ recognizes that the PSCW operates under different legislation than does the Commission. The ALJ is certain that just as the Commission is a creature of statute here in Michigan likewise the PSCW is a creature of Statute in Wisconsin. Therefore, its authority and regulatory reach is governed by the statutes enacted in Wisconsin. The ALJ on review of several of the cited statutory provisions finds a significant difference in the legislation governing in Wisconsin and the legislation governing in Michigan. In addition, to the legislative differences, the economic conditions between Wisconsin and Michigan are different. As noted by several witnesses, Michigan was harder hit by the economic downturn than was Wisconsin.

Michigan's recovery has lagged the national economic recovery. Michigan's recovery has also lagged Wisconsin's economic recovery. Michigan's unemployment rate remains the highest in the nation.

The ALJ finds that two significant features of the leases also warrant independent review. The financing of the project to build the ERGS units were never competitively bided before being awarded to the affiliate. The cost of the leases to We Energies exceeds the price We Energies charges its wholesale customers. The ALJ realizes that there are special circumstances which would warrant such an arrangement. However, there is not any evidence presented to warrant such an arrangement and the amount of the difference is significant.

Louisiana-Pacific points out and the ALJ agrees, that these leases have never before now been submitted to this Commission for approval. For these reasons, the ALJ recommends that the Commission independently review the ERGS leases.

The Wisconsin Power of the Future (PTF) program is described as follows:

> Power the Future or 'PTF' is a large investment program announced in September 2000, to expand WEPCo's existing power plants for improved efficiency and reduced emission, and upgrade WEPCo's distribution system. The PTF program includes, among other things, two new gas-fired generation units at the Port Washington Generating Station ("PWGS"), and two new coal-fired generation units at the Elm Road facility [ERGS]. 6 Tr 872-873.

The AG argues that the Code of Conduct applies to the terms and conditions of the PTF leases. The ALJ believes that the Code of Conduct does apply. The Code of Conduct states:

> An electric utility's or alternative electric supplier's regulated services shall not subsidize in any manner, directly or indirectly, the unregulated

> business of its affiliates or other separate entities. *MPSC Case No. U-12134,* dated October 29, 2001, Section 11.B.[4]

Further the Code of Conduct uses market prices or fully embedded costs as a measuring stick. The Code states:

> If an electric utility or alternative electric supplier offering regulated service in Michigan provides services, products, or property to any affiliate or other entity within the corporate structure, compensation shall be based upon the higher of fully embedded cost or market price. If an affiliate or other entity within the corporate structure provides services, products, or property to an electric utility or alternative electric supplier offering regulated service in Michigan, compensation for services and supplies *shall be at the lower of market price or 10% over fully allocated cost* and transfers of assets shall be based upon the lower of fully embed cost or market price. *Id,* Section III.C.

The FERC also applies a market based test to affiliate transactions. The FERC Rule provides:

> Unless otherwise permitted by Commission rule or order, and except as permitted by paragraphs (b)(3) and (b)(4) of this section, a franchised public utility that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, *may not* purchase or receive non-power goods or services from a market-regulated power sales affiliate or a non-utility affiliate *at or above market. (Emphasis added). 18 CFR § 35.44(b)(2).*

We Energies argue that the Code of Conduct does not apply or has been satisfied in this case. The ALJ disagrees. We Energies relies on Commission language which states that under certain circumstances the Code of Conduct would not apply. The Commission language states:

> Under these circumstances, as long as the FERC or another governmental regulatory agency requires adherence to a code or regulatory requirements that are equivalent to the Michigan code of conduct, it will not be necessary to adhere to this code. *MPSC Case No. U-12134,* dated October 3, 2002, p. 3.

[4] The Code of Conduct was established under the provisions of MCL 460.10a(4). The statute specifically mandated measures to prevent cross-subsidization and preferential treatment between a utility's regulated and unregulated services.

Wisconsin, from all that has been presented in this case, does not have a market based standard. Rather, the Wisconsin standard is prudent and reasonable. While prudent and reasonable is a perfectly acceptable standard, the ALJ finds that it is fundamentally different in nature than the Code of Conduct standard which specifically uses market prices or embedded prices. The question then becomes whether a reasonable standard is equivalent to a market standard. The ALJ believes that a reasonable standard is not the equivalent to a market price standard. A reasonable standard certainly might consider the market price but could include more factors some of which could be objective, some could be subjective. However, a market price standard uses as its basis, the market price. Once, the market price is satisfactorily determined all that is necessary is a comparison of the market price to the price in question. Under the provisions of a market based price, the market factors into consideration objective and subjective factors. The resultant market price is what the product, service, commodity, etc could be purchased at regardless of other contingencies.

A market based price leaves little doubt as to whether a product, service, commodity, or whatever satisfies the test. The ALJ is convinced that the Wisconsin reasonable standard is not equivalent to the market based standard of the code of conduct. As such, the ALJ finds that the Code of Conduct is applicable in this case.

The next issue involves which time period should control for appropriate market prices to apply to the leases. We Energies argues that the reasonableness of the leases must be evaluated at the market that existed at the time the leases were negotiated, finalized, and approved by the PSCW in 2002 and 2003. The AG argues that the appropriate time period is the time of approval of the leases in Michigan.

The ALJ finds that the answer lies in the difference between the regulatory policies of the respective states involved. In Wisconsin, the costs of plant under construction may apparently be included in current rates. In Michigan, the costs of plant under construction may not be included in current rates until the plant is constructed and in operation. In this case, the costs of the leases were deferred in Michigan. Therefore, for Michigan, the approval of the leases, absent some other regulatory policy, trigger the collection of the costs. The approval of the leases should logically flow from the conditions current at the time of the approval of the leases. The ALJ believes that there is not any other regulatory provision to the contrary.

The ALJ finds that the leases should be adjusted, if the Commission finds that the ERGS Unit #1 is used and useful, as follows.

1. Market Based Leases

The AG proposes that the Commission only permit We Energies to recover market based capacity charges of $2,753 per MW per month. This proposal is based on testimony of the AG's witness William W. Dunkel. 6 Tr 1106. Mr. Dunkel testified that the Regional Transmission Organizations (RTO) conduct production capacity auctions that provide a market price for production capacity. He states that MISO and PJM are two RTOs that serve portions of Michigan. Mr. Dunkel highlights the significance of the PJM since it administers the world's largest competitive wholesale electricity market. He notes that the PJM website shows results for six years of production capacity auctions.

Mr. Dunkel used a market price which is the average of six years of production to calculate the market price of $3,753 per MW per month. He believes that this market price is comparable to the types of production units addressed in the PTF leases. 6 Tr 1103. Mr. Dunkel compares this market price with the ERGS #1 lease under which We Energies would pay an average of $27,455 MW per month in 2010. Exhibit AG-18. The ALJ finds the result striking. We Energies is paying almost 7 times the market price for the PTF leases.

The ALJ is aware that We Energies argues that the auctions available under PJM were not in existence when the PSCW approved the leases in 2002-2003. However, the fact is that the PJM is in existence and it does now provide market prices for the purchase of generation. We Energies argues that the comparison of the PJM to the PTF leases is not comparable because of the length of the PTF leases which run for 30 years compared with the PJM which typically quotes for 8 months. The ALJ finds that even though We Energies is correct about the difference, this does not explain away the significant difference in costs between the PTF leases and the PJM.

Mr. Dunkel notes that the adoption of the market based production capacity negates the necessity to examine the Rate of Return and the Term of the Leases. The ALJ agrees. However, in the event the Commission determines it necessary to address the Rate of Return and Terms of the Leases, these factors are discussed below.

2. <u>Rate of Return</u>

The leases as proposed incorporate a return on equity of 12.7%. We Energies' return on equity is currently authorized at 10.55%. Staff and the ALJ recommend a return on equity in this case at 10.25%. The ALJ concurs with the Mines, that because of the contractual commitment from We Energies, We Power faces relatively little risk. At least, the record fails to show risk which justifies a return on equity of 12.7%.

The ALJ further concurs with Louisiana-Pacific. Louisiana-Pacific argues that We Energies in essence is requesting a return of equity which is frozen. Thus, the Commission would be guaranteeing a rate or return for 30 years, the contractual life of the initial phase of the lease. The point being that it is perfectly legitimate for the Commission to treat the leases in the same way it treats other rate based assets which would include a rate of return that varies over time. The ALJ believes that a return on equity of 10.25% is reasonable since it would match We Energies return on equity as recommended.

3. Lease Period

The proposed initial leases for the PWGS units are 25 years and 30 years for the ERGS units. The ERGS unit leases provide renewal provisions for three renewal periods of five, nine, and four years. The lease payments are reduced by 25% during the first renewal period. An additional 15% reduction during each of the subsequent renewals. The expected life of We Energies' steam power plant is 52 years according to it depreciation study. Exhibit AG-11.

The AG argues that the Uniform System of Account should direct that the lease term should be over the expected life of the PTF plants or 52 years. The AG notes that this would satisfy intergenerational equity as well.

We Energies counters that the term of the leases were driven, in part, by a tax law provision which would have resulted in a significant upfront tax payment if the term of the lease exceed 80% of the economic useful life which in the case of the ERGS units would have been less than 32 years. Also, due to uncertainties surrounding deregulation, We Energies did not want to be in the position of holding a utility plant bearing stranded costs. We Energies argues that given the specialized nature of the facilities being leased, it is reasonable for the lessor to recoup its investment in the initial lease term.

We Energies also notes intergeneration equity issues as being significant due to the Mines comprising about 68-75% of the Michigan load with the option to switch their entire service requirements to an Alternative Electric Supplier. MCL 460.10a(1)(d). We Energies points to the Mines proven reserves as a risk factor. Noting that the reserves at current production levels could be exhausted in a little as 6 years at Empire and 35 years at Tilden. We Energies argue that the terms are reasonable as cost based rates under the provisions of MCL 460.11(6).

The ALJ finds that We Energies has shown the reasonableness of the term for the PTF leases. The ALJ finds that there is considerable risk involved due to the factors cited by We Energies above. Significantly, the Mines have the legal option of moving the load to an AES. The ALJ recognizes that the term of the leases with the unregulated affiliate is not subject to the provisions of the USOA. The ALJ finds that in this case, We Energies has shown sufficient basis for recovery over a shorter period than the useful life.

4. <u>ERGS #2 Lease Expense</u>

We Energies rate relief includes ERGS #2 additional revenue requirement in the amount of about $4,406,563. We Energies conditions its request becoming effective only when ERGS #2 actually commences commercial operation. We Energies argue that its application is based on a test year January 1, 2010 through December 31, 2010. We Energies argues that with a final order due before July 2, 2010 under MCL 460.6a(3) and the ERGS #2 unit scheduled to commence operation in September, 2010 it is reasonable to include ERGS #2 expenses.

Staff, the Mines, Louisiana-Pacific and the AG recommends that lease payments for ERGS #2 be excluded since the commercial operation of ERGS #2 is after the expected date of the Commission order in this case.

The ALJ has prepared numerous findings and recommendations regarding the lease payment of the PTF units which would include ERGS #2. The ALJ's findings and recommendations include the recommendation that the ERGS #1 and ERGS #2 are not presently used and useful and should be phased in over time. However, the ALJ finds that conditioned on the Commission finding that the ERGS units are used and useful, then and only then would it be reasonable to include the ERGS #2 lease expenses in We Energies' 2010 projected test year subject, of course, conditioned on to the commencement of actual commercial operations of ERGS #2 and subject to market prices.

5. <u>ERGS #2 Operating and Maintenance Expense</u>

We Energies argue that Staff's proposed projected allocation of O&M expense of $11,313,111 for ERGS #2 is overstated. Ms. Wolter testified:

> In addition, the 5/17th allocation to ERGS Unit 2 is overstated. Most of the incremental O&M related to ERGS is related to ERGS Unit 1 and the common facilities. For instance, control room employees will be on site when ERGS Unit 1 and the common go into service; the addition of ERGS Unit 2 will not necessarily result in additional control room staffing. In response to TM-WE-089, therefore, we calculated the incremental O&M for ERGS Unit 2 to be $0. 4 Tr 505.

Staff states that an adjustment to O&M expense was necessary because it was not readily apparent in We Energies' filing what level of O&M expense was attributable to the ERGS units. Staff took the non-inflationary increase totaling $38,464,578 and attributed that amount to the O&M Expense for ERGS Units 1 and 2. Exhibit S-3. This amount was then prorated by assuming 12 months and 5 months of commercial operation for ERGS Units 1 and 2, respectively.

Again, subject to the finding that the ERGS units are used and useful, the ALJ recommends We Energies' proposed allocation of expenses. The ALJ is persuaded by the testimony of Ms. Wolter which supports the setting of O&M expense for ERGS #2 at $0.

6. <u>Zion Energy Purchase Power and Production Expense</u>

Zion Energy LLC Purchase Power Agreements (Zion PPA) were entered into by We Energies in 2002. The Commission has approved the costs associated with the Zion PPA long-term purchases and has in subsequent PSCR cases since the 2003 PSCR plan. *MPSC Case No. U-13266*, dated March 12, 2003.

Staff proposes removing Zion Energy Purchase Power and Production Expense due to the excessive generating capacity through the addition of the capacity added by the commercial operation of ERGS #1. Staff states that the Zion PPA is the least used and useful firm capacity. 6 Tr 1205. Staff also notes that even when the Zion PPA has been bid into the PJM market it has only been used sparingly. 6 Tr 1205. Staff believes that the actual removal of Zion PPA must be done in the PSCR process. However, Staff recommends removing the Zion PPA in this proceeding since its recommendation is directly related to the over capacity tied in with the commercial operation of ERGS #1. The AG supports Staff's request. However, the AG would seek removal of the Zion PPA in the PSCR Case No. U-16034.[5]

The ALJ finds the provisions of Act 304 is controlling on this issue. The Act provides in the following relevant section:

> …The commission may hold a full and complete hearing to determine the cost of fuel, purchased gas, or purchased power separately from a full and complete hearing on general rate case and may be held concurrently with the general rate case. The commission shall authorize a utility to the cost of fuel, purchased gas, or purchased power only to the extent that the purchases are reasonable and prudent…MCL 460.6a(2).

The ALJ finds that appropriate statutory authority exists for the Commission to review the Zion PPA in this rate case from the above section of Act 304. The statute clearly states that such a review may be conducted in a general rate case.

Upon review, the ALJ concurs with Staff and the AG. We Energies has hundreds of MWs of excess generating capacity. It should shed expenses related to the Zion PPA. The Zion PPA has been the least used and useful. It appears as though it is even difficult to bid out the purchased power to the PJM. The Commission in a general rate case has approved the removal from rate base of a facility of a utility generating plant where it has found excess capacity. *MPSC Case No. U-17760,* dated April 1, 1986, pp. 74-77. The ALJ finds the facts analogous to the situation here, except instead of the discussion focused on utility generating plant the focus here is on utility purchase power agreement.

The ALJ has considered the previous Commission findings that the purchase power agreements were reasonable and prudent cited by We Energies. The ALJ finds

[5] The ALJ is aware that MPSC Case No. U-16034 settled and the Commission approved the Settlement Agreement on April 13, 2010. The Settlement Agreement does not appear to have addressed the Zion PPA.

the relevant question in light of Act 304 is whether the purchased power agreements remain reasonable and prudent. In consideration of the commercial operation of ERGS #1 and the expected commercial operation of ERGS #2 in September 2010, there simply is excess generating capacity. The Zion PPA is not reasonable and prudent under these conditions.

7. Wisconsin Pollution Discharge Elimination System

In July 2008, We Energies, along with other joint owners of the Oak Creek expansion project settled with Clean Wisconsin, Inc. and the Sierra Club regarding Wisconsin Pollution Discharge Elimination System Permits. We Energies' SEC 10-K filing describes We Energies' share of this settlement as $4.2 million toward projects to reduce greenhouse gas emissions and about $3.3 million annually for 25 years to fund projects to address Lake Michigan water quality. We Energies describes these costs as subject to regulatory approval. We Energies is now seeking regulatory approval of these costs.

The Mines object to the recovery of these costs. The Mines argue that the costs were not sufficiently described in testimony to establish the reasonableness and prudence of the costs.

The ALJ finds that We Energies showed reasonableness and prudence concerning the litigation underlying the settlement agreement and the decisions involved in entering into the settlement agreement. Exhibit A-30 provides a summary of the litigation leading up to the settlement. The nature of the litigation involved the request by We Energies for a permit for water cooling for the ERGS units. The request initially went to the Environment Protection Agency (EPA) and subsequently to the

DNR. After a determination that the ERGS unit qualified as an existing facility a subsequent decision in the Court of Appeals (*Riverwood II)* raised issues regarding the initial determination.

We Energies decided to settle the case. The ALJ found We Energies' witness Roman A. Draba's testimony persuasive concerning the reasonableness of the settlement. Mr. Draba testified as to the merits of reaching a settlement. We Energies, he testified, balanced the risks of continued litigation, and the harm associated with the delay involved in continued litigation, and the consequences if they did not prevail in the litigation. The ALJ found the decision to settle reasonable and prudent.

8. <u>Renewable Energy</u>

We Energies agrees to an adjustment of $782,795 in revenue requirement for the 2010 test year. At dispute and discussed here is the Michigan allocation of $5.4 million for costs associated with the renewable energy program of Wisconsin. Exhibit MIN-21.

We Energies is required under Wisconsin law to meet a Renewable Portfolio Standards (RPS) which would include wind, solar, hydro, or biomass and PPA for renewable energy. The Wisconsin law requires all electric providers to increase their renewable electric generation as a percent of their Wisconsin sales. Under the law, We Energies is required to achieve 8.27% renewable energy for its Wisconsin retail sales by 2015.

We Energies plans to build or purchase several new renewable energy projects to meet the requirements of the Wisconsin RPS. We Energies, at present, owns the 145 MW Blue Sky Green Field Wind Energy Center. We Energies purchases 25 MW from the Badger Wind Farm. We Energies seeks to build a proposed 162 MW Glacier Hills Wind Park and plans to build a 50 MW bio-mass fueled power plant.

The Mines and Louisiana-Pacific challenge the allocation of costs of complying with the Wisconsin RPS to the Michigan ratepayers. They argue that We Energies already has far more generation than it needs and is continuing to build more generation to meet the Wisconsin RPS. The Mines and Louisiana-Pacific rely, in part, on the Michigan RPS law which limits the retail rate impact to ratepayers to support their position.

Michigan adopted the Clean, Renewable, and Efficient Energy Act in 2008. In the Act, Michigan, in part, chose to address the renewable energy policy from a cost to ratepayer's perspective. The relevant provisions provide:

> An electric provider shall not comply with the renewable energy standards to the extent that, as determined by the commission, recovery of the incremental cost of compliance will have a retail rate impact that exceeds any of the following:
> (a) $3.00 per month per residential customer meter.
> (b) $16.58 per month per commercial secondary customer meter.
> (c) $187.50 per month per commercial primary or industrial customer meter. MCL 460.1045(2)

Michigan further conditioned the provisions of Section 2 above to the approval of recovery by the commission for renewable energy which occur outside of the Clean, Renewable, and Efficient Energy Act. The relevant provision states:

> The retail rate impact limits of subsection (2) apply only to the incremental costs of compliance and do not apply to costs approved for recovery by the commission other than as provided in this act. MCL 460.1045(3).

We Energies argues that the provisions of the Clean, Renewable, and Efficient Energy Act contemplates and permits recovery of other renewable energy. We

Energies points out that provisions of the Act recognizes that utilities already purchase renewable energy as part of their overall power supply reserves. MCL 460.1027(3)(a)(i) and (ii). This, argues We Energies, does not prohibit recovery of renewable energy purchased or generated in the year preceding the effective date of the Act which is 2012-2015. The ALJ agrees. While there are limits on recovery of renewable energy to meet the requirements of the Act, the Act also seemingly permits utilities to recover qualifying renewable costs which exceed the requirements of renewable purchases to meet the requirements of the Act.

The Mines argues that We Energies' request is prohibited by the Act because the purchases necessary to comply with the Wisconsin Act are incremental purchases under the Act. The Mines classify such purchases as incremental because We Energies' fuel mix was 1% renewal energy and 1.4% hydroelectric prior to the enactment of the Wisconsin and Michigan renewable energy laws. We Energies' acquisition of renewable energy to achieve 8.27% by 2015 is clearly incremental to its historical levels. The ALJ does not agree.

The Clean, Renewable, and Efficient Energy Act defines the incremental cost of compliance. It states:

> 'Incremental costs of compliance' means the net revenue required by an electric provider to comply with the renewable energy standard, calculated as provided under section 47. MCL 460.1007(b).
>
> The Act further defines renewable energy standard as follows:
>
> 'Renewable energy standard' means the minimum renewable energy capacity portfolio, if applicable, and the renewable energy portfolio required to be achieved under section 27. MCL 460.1011(j).

The ALJ finds that the above provisions do not support the Mines position. The ALJ finds that the provisions above cited would only apply to renewable energy costs which are required for compliance with the Act. This is not the case here.

The ALJ concurs with the Mines observance that a paradox exits between the relationship of We Energies' excess capacity and We Energies' continued insistence to continue to build more and more generating plant. The ALJ fully understands the requirements of the Wisconsin RPS. However, the ALJ clearly sees the paradox and questions the continued reliance on the utility building new generating plant.

Mr. Gorman testified that We Energies is acquiring far more renewable energy than is necessary to satisfy the requirements of the Wisconsin RSP. Mr. Gorman prepared two tables which demonstrated this excess acquisition of renewable energy. The ALJ finds that Mr. Gorman's exhibit shows that the excess renewable energy he refers to is not just a minimum amount but for the years 2011 to 2014 the excess above the Wisconsin renewable statutory requirements ranges from 31% to 120% of the projections. 6 Tr 901.

The ALJ is aware as cited above that the Michigan legislature has capped the cost regarding the acquisition of renewable energy. The Michigan legislature clearly placed costs as a relevant factor. MCL 460.1045(2). Based on the above, the ALJ would recommend that the Commission adopt the Mines' proposal that renewable energy costs in excess of the Wisconsin Statutory requirement be disallowed. The ALJ in making this recommendation, is aware, as We Energies points out, MWs cannot generally be added in single MW increments. So for that reason, the ALJ suggests that the Commission establishment a renewable recovery range.

The Commission could determine a reasonable range which it determines would permit We Energies recovery of renewable energy acquisition. For example, according to Mr. Gorman's testimony in the year 2011 We Energies would exceed the Wisconsin requirement by 31%. 6 Tr 901. The Commission in its reasoned determination could set a range from of 0-20%. Any costs falling within the range would be recoverable under Michigan rates. Likewise, any costs falling outside the range would not be recoverable. For the 2010 test year, the projected excess of the Wisconsin RSP is only 4%. Therefore, for 2010 the ALJ recommends recovery.

9. Inflation Expense

We Energies presented the actual historical annual inflation rate for the 12 months December 2008 to December 2009 of 2.7% prepared by the Bureau of Labor Statistics. 4 Tr 457-458. We Energies proposed an inflation rate of 2.55% for 2010. We Energies' proposed inflation rate for 2010 represents the midpoint range of a consensus project of 2.1% and the Moore Inflation Predictors 3% or 2.55%.

Louisiana-Pacific reported from a number of sources to show that We Energies' proposed inflation rate was higher than recent experience and authoritative forecasts of inflation. Louisiana-Pacific recommends a much lower inflation adjustment than proposed by We Energies.

Staff recommended an inflation rate of negative 0.03% for 2009 and an estimated inflation rate of 1.55% for the full year 2010. Staff's proposed inflation rates are the result of a combination of forward-looking estimates provided by Value Line, Global Insight, and the Moore Inflation Predictor. Exhibit S-4, Schedule D-1, p. 3.

The ALJ reviewed Ms. Wolter's testimony concerning the 2009 inflation rate. The ALJ finds that Ms. Wolter testimony is that for December the inflation rate was 2.7%. The ALJ rejects We Energies' claim that 2.7% was the actual inflation rate for the entire year of 2009. The ALJ finds that Staff's projection of negative 0.03% for 2009 is reasonable based on its use of multiple reliable sources and the application of expert analysis. The ALJ likewise finds that Staff's proposed inflation estimate of 1.55% for 2010 is reasonable.

10. Fuel, Purchased Power and Production Expense – Production, Transmission and Distribution O&M Expense

We Energies proposes O&M expense in the amount of $1,412,839,513 for total company. Exhibit A-3, Schedule C5. The Michigan allocation would be $56,670,071. *Id.* We Energies notes that in its filing it has provided detailed forecasts of O&M costs by work order, by FERC account, by month all of which lend themselves to thorough review. Exhibit A-19. Ms. Wolter testified that We Energies relies heavily on its budget coordinators and SAP accounting system to compile all of the necessary data. She testified that it is reasonable to expect that the Company would reasonably respond to requests for supporting correspondence but it would be unduly burdensome to provide all of the correspondence and all supporting documents in its filings.

Staff proposed several adjustments to We Energies' O&M expense. Staff adjusted the O&M expense by applying its projected inflation rate rather than We Energies' projected inflation rate. Staff also adjusted O&M expenses by removing expenses related to ERGS #2. 6 Tr 1264-65. These two proposed adjustments by Staff resulted in a total adjustment of $26,690,000 ($15.38 million inflation adjustment and $11.31 million ERGS #2 adjustment). Staff recommends a total production, transmission and distribution O&M Expense in the amount of $1,001,025,901. Exhibit S-3, Schedule C5-R.

The AG supports Staff's proposed adjustment. The AG and Staff argue that We Energies' exhibit showing O&M expenses did not directly reflect its calculation of inflation. The AG took the next step and applied the O&M expenses to the Michigan allocation factor of 4.38% from Exhibit A-3, Schedule C5.

The ALJ recommends the adoption of Staff's proposed calculation of O&M expense except for the exclusion of ERGS #1 O&M expense. The ALJ has already recommended the application of Staff's proposed inflation factors for 2009 and 2010. The ALJ has also already recommended that the expenses associated with ERGS #1 and ERGS #2 not be recovered at this time. Therefore, the ALJ finds Staff's proposed adjustments with the exclusion of ERGS #2 O&M expense consistent with his previous findings and recommend its adoption.

11. <u>Other O&M Expense</u>

a. Customer Accounts

Staff presented a calculation of uncollectible expense by using a three-year average from 2006 to 2008. Staff argues that this is the historical method approved by the Commission to calculate uncollectible expense. Staff proposes an uncollectible expense in the amount of $23,658,000 and a total of $52,242,023 for uncollectible expense combined with other customer accounts as well. 7 Tr 1396 and Exhibit S-3, Schedule C5.5.

We Energies accepts Staff's adjustment. The ALJ recommends recovery of $52,242,023 for customer accounts which includes uncollectibles and other customer accounts as well. Exhibit C5-R.

b. Injury and Damages

We Energies initially proposed a projection of $12,790,014 for injury and damage expense. Exhibit A-3, Schedule C5, line 11. Staff proposed a projection for injury and damage expense of $11,139,557. Staff proposed using a three-year averaging to moderate the effects of volatility. We Energies accepted Staff's proposed calculation of injury and damage expense of $11,139,557.

c. Employee Pension and Benefits, Bonuses, Perquisites and Performance Units

We Energies projected $98,384,144 for Employee Pension and Benefit expense. Exhibit A-3, Schedule C5, line 12. Staff adjusted We Energies' proposal to remove projected bonus payout and executive perquisites in the amounts of $13,598,981 and $8,058,264 for a total reduction of $21,657,245. 6 Tr 1274-1276. This adjustment incorporates the adjustments proposed by the Mines and Louisiana-Pacific. We Energies accepts Staff's adjustment. The ALJ recommends recovery in the amount of $76,726,899. 6 Tr 1273, Exhibit S-3, Schedule C5-R, line 4.

d. Financial Accounting Standards Board 87 Pension Expense

We Energies requests $25,879,911 for Financial Accounting Standards Board (FASB) 87 pension expenses. Exhibit AG-07, Attachment 1, line 6. Staff accepted We Energies request.

The AG contests the veracity of the amounts. The AG argues that there was insufficient spreadsheet data to ascertain the veracity of the amounts entered. The

AG's witness Bruce W. Walter, acknowledging that he was not a financial expert, testified that since the stock market has regained a considerable amount of the value lost in 2008, it is difficult to believe that the FASB 87 expenses would be anywhere as high as those calculated for 2008. Mr. Walter recommends that a three-year average of actual data be used as a proxy for future FASB 87 expenses.

We Energies argues that the mere fact that the projected expense is higher than prior levels is not a reason to undermine the reasonableness of the projection. We Energies states that they responded to the AG's request for supporting documents. We Energies argues that the stock market gains in 2008 does not negate the obligation to amortize in 2010 a portion of the loss suffered in 2008. We Energies argues that the AG has not supported its claim by any substantive evidence.

The ALJ agrees with We Energies. The AG has not substantiated its claim nor shown why a three-year average would be more reasonable than We Energies' projection. As We Energies points out it has an obligation to amortize a portion of the 2008 stock market loss in 2010. This obligation cannot be satisfied through a three-year average. In addition, Staff witness Dolores A. Midkiff-Powell testified that these costs are largely beyond the control of the Company. The ALJ finds that We Energies' proposal is reasonable since its purpose is to reduce the risk that projections of volatile costs are as accurate as can be.

e. Customer Service

We Energies accepts Staff's proposed adjustment of Customer Service expenses in the amount of $52,928,325.

f. Remaining Other O&M Expenses

The remaining other O&M expenses include the categories Sales, Administrative and General – Salaries, Administrative and General Expense Transferred Credits, Outside Services, Property Insurance, Regulatory Commission Expense, Duplicate Charges Credit, Advertising, Miscellaneous General Expenses and Office Supplies and Expenses. Exhibit S-3, C5-R, lines 5-15. We Energies accepts Staff's proposed projection of $161,666,294. 6 Tr 1278.

The AG supports Staff's methodology but calculated a slightly different result. The ALJ recommends Staff's calculation and projection of $161,666,294.

g. Allocation of Common Board of Directors Expense

We Energies proposes $1,997,250 for fees and expenses associated with the Board of Directors of its board, WEC and Wisconsin gas. 4 Tr 466. All three boards of directors share the same directors. Ms. Wolter testified that the arrangement of having the same directors on all three boards permits shared knowledge and simultaneous scheduling of board meetings. She states that this reduces costs. Also, the manner in which the directors are compensated is designed to reduce costs. The costs are paid by WEC and then allocated among the entities with We Energies allocated 78% of the expense. She testified that We Energies' allocated costs is less than it would be on a stand alone basis. Staff does not take exception to We Energies request for recovery of board of director costs.

The Mines challenge the allocation. The Mines argues that the PSCW rejected the costs.[6] The PSCW in rejecting the costs, reasoned that since WEC has divested

[6] PSCW Case No. 5-UR-104, dated December 18, 2009.

itself of significant portion of its utility holdings, as such utility business becomes a greater percentage of the board's activities. The PSCW then states:

> This argument, if taken to the extreme where WEC divests itself of all non-utility holdings, would suggest that all WEC Board of Director costs should be allocated to the utility business and the utility business would pay for two boards of directors, their own plus WEC's. *id,* p. 28.

The ALJ admits he does not fully understand the PSWC's reasoning. It would seem reasonable where there is a joint board, where a joint board is not prohibited by rule or law, where the costs of the board are being monitored, and where the apportionment of costs is directly related to allocation of the holdings of WEC, that such costs would be recoverable. The ALJ recommends the recovery of $1,997,250 as requested.

C. <u>Depreciation and Amortization Expense</u>

Based upon its current depreciation rates, We Energies projects a 2010 test year depreciation expense of $235,754,852. Exhibit A-3, Schedule C6. On April 13, 2010, the Commission approved We Energies' filing to revise its depreciation rates. We Energies agreed to reduce its revenue requirements by $1,419,000 for the test year 2010 if the Commission's approved its revised depreciation rates. The Commission has done so. The ALJ recommends We Energies' proposed reduction of $1,419,000.

D. <u>Taxes</u>

We Energies accepts Staff's methodology and calculation of taxes. We Energies notes that there may need to be some adjustments based on actual Commission findings concerning revenues, expenses, and rates. The parties did not otherwise raise any issues regarding taxes. The ALJ recommends Staff's proposed taxes as follows:

Taxes – Other than Income Taxes ……..$113,072,639 (Exhibit A-3, Schedule C7)
Federal Income Taxes…………………....$40,113,705 (6 Tr 1141)
MiBT……………………………………..$1,536,751 (Exhibit S-3, Schedule C9-R)
WiIT………………………………………$17,078,675 (Exhibit S-3, Schedule C9-R)

E. Revenue Multiplier

Staff accepted We Energies' Revenue Conversion factor of 1.6698. This figure is not disputed.

VII.

REVENUE DEFICIENCY

In accord with the findings as set forth above, the ALJ recommends We Energies' base revenue deficiency for the 2010 test year as follows:

Rate Base	$327,222,306
Rate of Return	7.06%
Income Requirement	$ 23,101,895
Adjusted Net Operating Income	$ 16,519,740
Income Deficiency	$ 6,582,155
Revenue Multiplier	1.6698
Revenue Deficiency	$ 10,990,883

VIII.

COST OF SERVICE STUDY, COST ALLOCATION AND RATE DESIGN

We Energies states that it prepared its COSS based on the Commission order in MPSC Case No. U-15895. The COSS was served on the parties in Excel format. Four issues will be addressed regarding the allocation of costs to rates.

A. Jurisdiction Allocation – Transmission Expense

We Energies allocated its transmission expense among the jurisdiction using the 75% demand/25% energy formula set by the Commission in MPSC Case No. U-4771, dated May 10, 1976. Staff also used this jurisdictional allocation factor.

The Mines propose a 12 CP allocation methodology. The Mines note that We Energies is assessed transmission service charges by the American Transmission Company (ATC) on the basis of ATC's 12 monthly coincident peak demands. We Energies then allocates these costs to Michigan customers on the basis of 12 CP 75%/25% demand/energy allocation. The Mines argue that this mismatch results in an over allocation of transmission expense to the Mines.

The ALJ concurs with the Mines. In Michigan, the allocation of costs of service is mandated by statute. The law states:

> The cost of providing service to each customer class shall be based on the allocation of production-related and transmission costs based on using the 50-25-25 method of cost allocation. MCL 460.11(1).

The Commission has stated that the legislative allocation formula should be understood to consist of a 50% weighting of peak demand, a 25% weighting of on-peak energy use, and a 25% weighting of total energy use. *MPSC Case No. U-15244,* dated

December 23, 2008. We Energies incurs transmission expense on the basis of 12 CP. We Energies allocates its transmission expense in Wisconsin on a 12 CP basis. The ALJ finds that the Mines have presented a compelling case for the allocation of transmission expenses based on the 12CP methodology.

B. Allocation of Costs Among Michigan Rate Classes

1. Distribution O&M Cost, Depreciation and Property Taxes

We Energies argues that its methodology for allocation of different components of distribution costs including substation O&M costs, depreciation and property tax are appropriate and do not unjustly burden the Mines. We Energies' witness Eric Alan Rogers explained that the only distribution costs allocated to the Mines are costs related to substations and metering. He testified that all costs of other components of distribution system are allocated zero cost to the Mines. Exhibit A-6, Schedule F1, Sec 6, cells J25-J35.

On rebuttal, Mr. Rogers testified that We Energies is required by the Commission to allocate distribution plant costs on the basis of demand. He further testified that allocation among customer classes based on demand is more appropriate than allocation based upon total plant assigned to each rate class. This, he states, eliminates disparate treatment of specific customers based upon the cost of the specific substation plant serving them. 5 Tr 629.

The Mines state that We Energies' COSS shows $7.7 million invested in substation-related total utility plant in Michigan. The Mines are allocated $4.4 million or 57.1% of the costs based on non-coincident peak (NCP) demand allocation. 5 Tr 795. In addition to the substation-related costs, the Mines note that We Energies also distributes $301,483 in substation-related O&M costs, plus $408,389 in depreciation expenses to its Michigan customers with the Mines being allocated 57.1% of those costs as well. The Mines argue that this methodology is unjust and unreasonable. It overstates the costs of serving the Mines and is not reflective of actual costs of service to the Mines.

The Mines also rely on the unique configuration of the nature of the service it receives from We Energies as a basis for challenging distribution costs allocated to it. The Mines show that it is served from two dedicated substations which are physically and electrically separated from each other and physically and electrically separated from the rest of We Energies' distribution system. Exhibits MIN-122 and MIN-123. The exhibits show that service provided by ATC is delivered directly to the Empire and Tilden Substations at a voltage of 138 kV. Through We Energies' owned electric distribution components consisting of primarily transformers, associated switchgear, and metering equipment, the voltage is stepped down and delivered at 13.8 kV. The Mines argue that they do not use any portion of We Energies' general distribution system network.

The Mines' witness David L. Stowe testified that the Empire and Tilden substation plants costs are $2,583,468. He compared the $2,583,468 with the $4,403,804 allocated in We Energies COSS. He states that the allocation of costs to the Mines is in excess of $1.82 million or 70.5%. Mr. Stowe also determined that the amount of expenses and taxes allocated to the Mines represented an over allocation as well.

The Commission directed that the cost of service data shall be based upon the following apportionment methods:

1. Average 12-month peak demand responsibility.

2. Production and transmission plant assigned as 75% demand related and 25% energy related.
3. Specific distribution plant such as meters and service drops used exclusively for a given customer shall be customer related. All other distribution plant shall be treated as demand related. *MPSC Case No. U-4771,* dated May 10, 1976, p. 2, part 1.

The ALJ finds that there is not clear direction from the COSS opinions issued thus far to address either the specific facts and circumstances in this case. The substations serving the Mines are not used to service other customers. As such, Mr. Rogers' testimony that all retail customers are served by the substations is not completely descriptive of the Empire and Tilden substations.

Another concern, this time concerning the Mines' request is that, at this point in time, the substations have been partially depreciated. Thus, the Mines would not experience the true COSS associated with the actual construction of the substations. Furthermore, the ALJ is aware that the allocation of costs if not allocated to the Mines would be shifted to other Michigan customers. The ALJ finds that neither We Energies' methodology nor the Mines' request is completely supported by COSS opinions issued thus far. The ALJ respectfully seeks Commission guidance for it determination on this issue.

C. <u>Curtailable Demand Credit</u>

We Energies is not proposing any changes to its curtailable (non-firm) demand credit. We Energies notes that the curtailable credit amount was last revised in MPSC

Case No. U-15071, dated May 22, 2007. That case established the curtailable credit amount based upon the marginal cost of production. Subsequently, analysis supported a reduction in the credit amount, however We Energies elects to maintain the level of the credit due to rate stability. MPSC Case No. U-15500. We Energies expects that in its next rate case an increase of 20.6% over the estimated 2006 cost is in order. We Energies requests not to change the credit amount based on rate stability.

Louisiana-Pacific takes service from We Energies on curtailable rate cp3. Under cp3, Louisiana-Pacific is entitled to curtailable demand credit for curtailing demand during peak usage hours. The credit is calculated based on the amount per kW of on-peak hours of use. Louisiana-Pacific states that these credits are based on the marginal cost of new capacity which We Energies states is the cost of a new combustion turbine. 7 Tr 1330. Louisiana-Pacific argues that despite seeking a vast increase in the price of electricity and despite maintaining the ability to curtail energy, We Energies proposes to leave the credit unchanged.

The ALJ concurs with Louisiana-Pacific. The ALJ recommends the changes proposed by Louisiana-Pacific with regard to the curtailable credits. Mr. King testified that We Energies proposes to increase the demand charge for medium voltage primary customers by 35%. He reasons if peak demand charges increase then the credits for avoiding that peak demand through curtailment should increase also. Mr. King applied the Handy-Whitman indexes which show turbo generator indices have increased since 2006 at 12.48%. This results in a cumulative increase of 60.1%. 7 Tr 1331. The ALJ found Mr. King's testimony reasonable.

Staff disagreed with We Energies' proposal to maintain the curtailable demand credit at current levels. Staff states that doing so impacts other We Energies' customers. The ALJ likewise rejects We Energies arguments concerning maintaining rate stability, Mr. King's improper use of the Handy-Whitman indices, and that only production costs may be saved through the curtailing of load.

D. LED Street Lighting Rate

On April 27, 2010, the Commission approved We Energies' request for new LED Street Lighting tariff. We Energies requests authority to update its LED tariff to implement the changes ordered in its LED Street Lighting tariff. There was no opposition filed. The ALJ concurs with this request.

IX.

TARIFF AND OTHER MATTERS

A. Tariff Proposals

We Energies offered Exhibit A-6, Schedule F5 which is its entire list of proposed changes to its rules and regulations. Intervenors did not address We Energies proposed changes. Staff took exception to proposed changes for the Line Extension rules. We Energies accepts Staff's position on this issue. We Energies also seeks to withdraw its proposed revisions concerning charging a customer on a secondary rate, who is taking primary voltage, the primary voltage charge and the manner in which curtailable demand credit is calculated.

B. Point Beach Proceeds

We Energies asserts that it is in compliance with the Commission directives, issued in its December 16, 2009 order in this case, concerning the Point Beach proceeds. There appears to be no dispute on this point.

X.

CONCLUSION

The ALJ recommends that the Commission issue an order adopting his findings, recommendations, and conclusions authorizing We Energies to increase its rates for the distribution and supply of electric energy in the annual amount of $10,990,883.00.

STATE OFFICE OF ADMINISTRATIVE
HEARINGS AND RULES
For the Michigan Public Service Commission

Daniel E. Nickerson, Jr.

Digitally signed by Daniel E. Nickerson, Jr.
DN: cn=Daniel E. Nickerson, Jr., c=US, email=denicke@michigan.gov
Date: 2010.05.07 17:04:27 -04'00'

Daniel E. Nickerson, Jr.
Administrative Law Judge

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